

AT RICHMOND, APRIL 17, 2006

APPLICATION OF

VERIZON VIRGINIA INC.

and

VERIZON SOUTH INC.

CASE NO. PUC-2006-00031

For Approval of a Revenue Neutral Rate  
Restructuring Proposal Pursuant to Section G  
of Their Plan for Alternative Regulation

2006 APR 17 P 12:04

ORDER DISMISSING APPLICATION

On February 23, 2006, Verizon Virginia Inc. ("Verizon Virginia") and Verizon South Inc. ("Verizon South") (collectively, "Verizon" or the "Companies") filed an Application with the State Corporation Commission ("Commission") for approval of a revenue neutral rate restructuring proposal ("Proposal" or "Rate Proposal") pursuant to Section G of the Companies' Plan for Alternative Regulation ("Plan"). Verizon states that the "Proposal is designed to offset in part, Verizon's \$52 million reduction in annual access charge revenues by modifying certain local exchange rates and thereby increasing revenues by approximately \$15 million."<sup>1</sup>

Specifically, Verizon proposes: (1) to increase Message Unit Charges from 9.6 cents (for Verizon Virginia) and 8.0 cents (for Verizon South) to a standard 10.5 cents; (2) to "simplify Measured Charges by reducing Verizon Virginia's seven mileage rate bands and Verizon South's five bands into only two rates for the existing bands, making those rates consistent throughout Verizon's territory in Virginia;"<sup>2</sup> (3) to modify Directory Listing rates by applying "Verizon South rates for additional listings, non-listed service, and non-published service, all of which are

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<sup>1</sup> Application at 1.

<sup>2</sup> *Id.* at 5.

optional services, to Verizon Virginia's services;"<sup>3</sup> and (4) to "standardize prices across Verizon's Virginia territory by increasing the price for Directory Assistance calls to 75 cents, changing the price for connecting the call to 35 cents, and decreasing the call allowance from 3 calls to 2 calls for residential customers and from 3 calls to no free calls for business customers."<sup>4</sup>

On March 7, 2006, the Staff of the Commission ("Staff") filed a Motion to Dismiss. The Staff "moves for a Commission order dismissing this matter because the Rate Proposal as demonstrated in the Companies' application would produce a net increase in operating revenues based on Verizon's current revenues, thereby violating the requirements of Section G of the Plan."<sup>5</sup> The Staff asserts that the revenue reductions "in switched access service included in the Rate Proposal have already been implemented as a result of an earlier docket," and that "[r]evenue neutral proceedings should be conducted in a single docket that allows all affected customers to participate."<sup>6</sup> In addition, the Staff contends that the "application is devoid of any factual supporting documentation or evidence."<sup>7</sup>

On March 17, 2006, Verizon filed a response to the Staff's Motion to Dismiss ("Verizon's Response"). Verizon states that its Proposal is consistent with the Commission's February 9, 2005, Final Order<sup>8</sup> reducing the Companies' intrastate access rates. Verizon asserts that its "Plan does not require access charge reductions and offsetting increases to occur in the same case to be

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<sup>3</sup> *Id.* at 5-6.

<sup>4</sup> *Id.* at 6.

<sup>5</sup> Staff's Motion to Dismiss at 1.

<sup>6</sup> *Id.* at 2, 7.

<sup>7</sup> *Id.* at 7.

<sup>8</sup> *Petition of AT&T Comm. of Virginia, LLC for reductions in the intrastate carrier access rates of Verizon Virginia Inc. and Verizon South Inc.*, Case No. PUC-2003-00091, Final Order (Feb. 9, 2005) ("Access Order").

revenue neutral."<sup>9</sup> Verizon also contends that the Commission may approve the Proposal under Section F of the Plan, "the existing price ceiling notwithstanding."<sup>10</sup> In addition, the Companies argue that "[a]s a threshold matter, Verizon's Application complies with the Commission's requirements under 5 VAC 5-20-80(A), which does not require at the pleading stage the sort of detailed evidence Staff demands."<sup>11</sup>

On March 27, 2006, the Office of the Attorney General, Division of Consumer Counsel ("Consumer Counsel") filed a response to the Staff's Motion to Dismiss ("Consumer Counsel's Response"). Consumer Counsel states that in the Commission's January 5, 2005, Final Order<sup>12</sup> approving the Plan, "it appears the Commission contemplated a revenue neutral filing would contain both increases to BLETS (or OLETS) and decreases to access charges to be considered simultaneously by the Commission."<sup>13</sup> Consumer Counsel also supports the Staff's statement that, "if revenue neutral rate changes, both increases and decreases, are not considered concurrently, 'Verizon essentially has a line of credit and is free to dredge up previous rate reductions and propose offsetting rate increases now and in the future.'"<sup>14</sup> Consumer Counsel concludes that "[u]nless the Commission contemplated that previously ordered and implemented

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<sup>9</sup> Verizon's Response at 5 (emphasis removed).

<sup>10</sup> *Id.* at 7-8. Section F.1 of the Plan states as follows: "Price changes for [Basic Local Exchange Telephone Services ('BLETS')] and [Other Local Exchange Telephone Services ('OLETS')] shall be governed by 20 VAC 5-417-50(D), (E), and (G) unless otherwise ordered by the Commission, except the price ceiling shall be as set forth in Section F.2, F.3, and F.4 below."

<sup>11</sup> Verizon's Response at 8 n.16.

<sup>12</sup> *Application of Verizon Virginia Inc. and Verizon South Inc. for approval of a plan for alternative regulation*, Case No. PUC-2004-00092, Final Order (Jan. 5, 2005) ("Plan Order").

<sup>13</sup> Consumer Counsel's Response at 3.

<sup>14</sup> *Id.* at 4 (quoting Staff's Motion to Dismiss at 5).

access charge reductions could be offset by a subsequent rate filing under Section G of Verizon's [Plan] that includes only increases, the Motion [to Dismiss] should be granted."<sup>15</sup>

On March 27, 2006, Verizon filed a Motion to Amend Application, along with an Amended Application. Verizon states that its Amended Application "adds Section F of the Plan as an alternative authority under which the Commission may approve Verizon's Proposal."<sup>16</sup> Verizon contends that its Proposal is "consistent with Section F of the Plan[,which] states: 'Price changes for BLETs and OLETs shall be governed by 20 VAC 5-417-50 (D), (E), and (G) unless otherwise ordered by the Commission, except that the price ceilings shall be as set forth in Section F.2, F.3, and F.4 below.'"<sup>17</sup> Specifically, Verizon asserts that the Commission may approve the Proposal under 20 VAC 5-417-50 (E), which permits "approval of pricing structures or rates that do not conform with the price ceilings."<sup>18</sup> The Companies conclude that "[t]hus, the Commission, independently of Section G, may approve Verizon's Proposal, the existing price ceiling notwithstanding, 'unless there is a showing the public interest will be harmed.'"<sup>19</sup>

On March 31, 2007, the Staff filed a reply to Verizon's Response ("Staff's Reply"). The Staff states that the "plain language of Section G 1 of Verizon's Plan permits only those rate proposals that ' . . . do not result in a net increase in operating revenues for the Companies'" and that, to the contrary, the Proposal "consists of nothing but rate increases that will, based upon Verizon's projections, increase the net operating revenues of the Companies."<sup>20</sup> The Staff also

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<sup>15</sup> *Id.* at 5.

<sup>16</sup> Verizon's Motion to Amend Application at 2.

<sup>17</sup> Amended Application at 4 (quoting Section F of the Plan).

<sup>18</sup> *Id.* (quoting 20 VAC 5-417-50 (E)).

<sup>19</sup> *Id.* at 5 (quoting 20 VAC 5-417-50(E)).

<sup>20</sup> Staff's Reply at 2 (quoting Section G.1 of the Plan).

asserts that "[a]ll revenue neutral proposals considered by the Commission have matched contemporaneous price increases and decreases that resulted in no net increase to operating revenues."<sup>21</sup> The Staff contends that the "contemporaneous consideration of the increases and decreases allows all affected customers to participate" and that the "public interest can be preserved when all affected customers have notice and an opportunity to participate in the analysis and consideration of the package of rates proposed for increases and decreases."<sup>22</sup> The Staff disagrees with Verizon's assertion that its Proposal is supported by the Access Order. Furthermore, the Staff states that Verizon has not filed sufficient data to evaluate the Application, and that "at a very minimum the application should include the necessary information to determine whether it is in fact revenue neutral as Verizon claims."<sup>23</sup>

The Staff also opposes Verizon's Amended Application. The Staff states that 20 VAC 5-417-50 (E) is part of the CLEC Rules,<sup>24</sup> which apply to new entrants. Thus, the Staff argues that "Verizon is not a new entrant" and that "Verizon is not a carrier covered by . . . 20 VAC 5-417-50 (E)."<sup>25</sup> In addition, the Staff declares that: (1) "Staff previously identified [its] concerns with allowing references to the CLEC Rules in Verizon's Plan; (2) "the Commission permitted the references to remain in the Plan as proposed by Verizon;" and (3) the "clear language of this CLEC Rule makes it evident that Verizon's premise is circular and unworkable when applied to incumbents."<sup>26</sup>

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<sup>21</sup> *Id.* at 3 (emphasis removed).

<sup>22</sup> *Id.* at 4 (emphasis removed).

<sup>23</sup> *Id.* at 11.

<sup>24</sup> "CLEC" stands for competitive local exchange carrier.

<sup>25</sup> Staff's Reply at 8-9.

<sup>26</sup> *Id.* at 8.

NOW THE COMMISSION, having considered the pleadings and applicable law, is of the opinion and finds as follows. We grant Verizon's Motion to Amend Application, and we consider below Verizon's Proposal based on both Sections G and F of the Plan, *seriatim*:

Section G of the Plan

Section G of the Plan states as follows:

G. Revenue-Neutral Price Changes.

1. Nothing in this Plan shall be construed to prohibit the Companies from proposing changes in the price of any BLETS, OLETS, or switched access services that do not result in a net increase in operating revenues for the Companies. The notification provisions of § 56-237.1 of the Code of Virginia will be applied to such proposals; and if a protest or objection to the revenue-neutral restructuring is filed by the lesser of 150 or 15% of the affected customers, or by an affected carrier, the Commission shall, upon reasonable notice, conduct a public hearing concerning the lawfulness of the restructuring, pursuant to § 56-235.5 of the Code of Virginia. The Commission shall approve such rate changes if it finds that they are in the public interest, or the Commission may refuse to approve the filing if it is not in the public interest or otherwise fails to comply with this Plan. Any price approved under this section that exceeds the then current price ceiling (established under Section F.2) for a BLETS will become the new price ceiling for that service and will thereafter increase in accordance with Section F.2.

2. The Commission may require the Companies to show within the first two years following the implementation of the price changes that the changes are, in fact, revenue neutral. If they are not, the Commission may require a prospective adjustment in the affected prices to ensure revenue neutrality.

Section G is not ambiguous. Under Section G.1, the Companies are not prohibited from "proposing changes in the price of any BLETS, OLETS, or switched access services that do not result in a net increase in operating revenues for the Companies." Verizon is "proposing changes" to the price of BLETS and OLETS, which result in increased revenues. Verizon is not, however, "proposing changes" to the price of access charges; the changes to access charges

relied upon by Verizon herein were ordered by the Commission over one year ago.<sup>27</sup> Therefore, Verizon is "proposing changes" that result in a net increase in operating revenues and, thus, that fail to comply with the express terms of Section G.1 of the Plan.

Contrary to the Companies' assertion, Section G.1 does not state that Verizon may propose changes to increase operating revenues to offset, in whole or in part, previously implemented changes that decreased revenues. Verizon attempts to overcome this lack of ambiguity by isolating the following passage from the Access Order:

The Plan gives Verizon new flexibility in its pricing for local exchange services and, among other things, allows Verizon to increase local exchange rates. The Plan also permits Verizon to seek revenue-neutral price changes for local exchange and switched access services. As a result, the new Plan gives Verizon reasonable tools with which to address the access charge reductions required herein if it so chooses.<sup>28</sup>

The Access Order does not modify Section G.1 of the Plan. Rather, the Access Order explains that the Plan allows the Companies to implement substantial rate increases for BLETS and OLETS, with rate ceilings that automatically increase on an annual basis. Accordingly, the Access Order recognizes that the Plan's new pricing flexibility provides Verizon with opportunities for additional operating revenues. Indeed, Consumer Counsel asserts that in September 2005, Verizon exercised such flexibility to raise rates and to increase operating revenues by approximately \$25 million.<sup>29</sup>

In addition, the Access Order recognizes Verizon's ability to file a revenue-neutral application proposing a price increase for local exchange services coincident with a price

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<sup>27</sup> Access Order at 10.

<sup>28</sup> *Id.* at 7 (footnote omitted).

<sup>29</sup> Consumer Counsel's Response at 4 n.5.

decrease for switched access services. The Access Order explicitly states that the rate reductions ordered therein "do not result in a specific cost-based rate and may not eliminate all of the subsidies currently built into Verizon's access charges."<sup>30</sup> We also found that Verizon did not establish that its rates were insufficient to cover its cost of providing service.<sup>31</sup> Thus, as referenced in the above passage from the Access Order, if Verizon sought to eliminate any remaining subsidies included in access charges, it could seek revenue-neutral price changes for local exchange and switched access service. Verizon, however, has not elected to do so. Rather, the Companies have initiated the instant proceeding, which seeks increases in local exchange rates that are not balanced by further decreases in access charges.

The Plan Order further confirms that a revenue-neutral proceeding under Section G.1 will consider revenue increases and decreases at the same time. Specifically, the Plan Order explains that Consumer Counsel, in that proceeding, sought to modify Section G "to require Verizon to use any additional revenues generated by the Plan to offset any revenue reductions that may result in the future from reduced switched access charges."<sup>32</sup> We rejected Consumer Counsel's request, explaining that "if the Company makes a revenue-neutral filing that seeks to increase BLETs *and* decrease access charges, Consumer Counsel could argue at that time that such price changes are not in the public interest until additional revenues generated through rate increases under the Plan are used to offset certain revenue reductions."<sup>33</sup> Thus, the Plan Order rejected Consumer Counsel's request to include prior revenue *increases* in the mathematical calculus for

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<sup>30</sup> Access Order at 6.

<sup>31</sup> *Id.* at 7.

<sup>32</sup> Plan Order at 20.

<sup>33</sup> *Id.* at 21 (emphasis added).



determining revenue neutrality under Section G.1. The converse is equally applicable; we reject Verizon's request to include prior revenue *decreases* in calculating net operating revenues under Section G.1.

In addition, we find that retroactively converting the access charge case into "phase one" of a revenue-neutral proceeding – as Verizon is, in effect, requesting – raises due process concerns. The access charge case was neither noticed, nor conducted, as a revenue-neutral proceeding. Indeed, Verizon did not bring the access charge case; it was initiated by AT&T and survived a motion to dismiss by Verizon. Interested persons that may have participated had such case been noticed and conducted as a revenue-neutral proceeding were not given that opportunity, since it was not so noticed, nor conducted. As explained by the Staff: "Perhaps, had those customers known that such decreases for the benefit of interexchange carriers would be used against them later to justify increasing their local rates, they could have intervened to oppose the reduction of switched access charges."<sup>34</sup> Accordingly, in every revenue-neutral case previously considered by the Commission, price increases and price decreases were proposed and considered together in the same proceeding.<sup>35</sup> This should not be surprising, since common sense dictates that the changes proposed in a revenue-neutral case must be, in fact, revenue neutral.

Finally, the Companies' Application is facially deficient. The Application requests revenue increases, but provides neither estimates nor support as to the amount of increased revenue that Verizon asserts will accrue from each requested pricing change. Moreover, in the access charge case the Hearing Examiner found that the precipitous drop in switched minutes of

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<sup>34</sup> Staff's Reply at 4.

<sup>35</sup> See *id.* at 3.

use is resulting in a concomitant drop in access charge revenues.<sup>36</sup> Verizon's claimed revenue loss from access charge reductions can only be considered as purely speculative in that the Application includes neither a proposal nor support for calculating the actual decrease in access revenues. In order for the Commission to approve an application "proposing changes ... that do not result in a net increase in operating revenues," such application must at a minimum include sufficient information, which the applicant is prepared to prove to the Commission's satisfaction, demonstrating that the proposed changes do not result in a net increase in operating revenues.

#### Section F of the Plan

As with Section G, Section F of the Plan is not ambiguous. Section F states as follows:

##### F. Price Changes for BLETs and OLETs.

1. Price changes for BLETs and OLETs shall be governed by 20 VAC 5-417-50 (D), (E), and (G) unless otherwise ordered by the Commission, except the price ceiling shall be as set forth in Section F.2, F.3, and F.4 below.
2. The price ceiling for each Company-specific BLETs shall be the lower of: (a) the 1994 rate for each Company-specific BLETs, including Company-specific BLETs on an individual rate group basis, adjusted annually by the Gross Domestic Product Price Index (GDPPI) through 2004; or (b) the highest tariffed price in effect for BLETs in either Company on the effective date of this Plan. Thereafter, the price ceiling for BLETs will increase annually on the anniversary of the effective date of the Plan by an amount equal in percentage terms to the increase in the GDPPI during the past twelve months.
3. The Gross Domestic Product Price Index used to determine limits on price ceiling increases shall be the final estimate of the Chain-Weighted Gross Domestic Product - Price Index as prepared by the U.S. Department of Commerce and published in the Survey of Current Business, or its successor.
4. During the first twelve months following the effective date of this Plan, price increases for BLETs and OLETs may not exceed

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<sup>36</sup> See Access Order at 2-3.

10%. Thereafter, the increase may not exceed a percentage amount calculated by multiplying .0083 times the number of months (equates to 10% per twelve-month period) since the most recent increase. Prices for BLETs and OLETs may only be increased if the service has not experienced an increase in the previous twelve months. In no event may any single increase exceed 25% nor result in the price for a BLETs that exceeds the ceiling in Section F.2 above. Unless otherwise permitted by the Commission, a Company may not charge higher BLETs rates in a lower rate group than in a higher rate group for that Company.

In the Amended Application, Verizon states that the Commission may approve the Proposal under 20 VAC 5-417-50 (E) as referenced in Section F.1, above. Rule 20 VAC 5-417-50 (E) states as follows:

E. A new entrant<sup>37</sup> may petition the commission for approval of pricing structures or rates that do not conform with the price ceilings. The new entrant shall provide appropriate documentation and rationale to support any request. The commission may permit such alternative pricing structures and rates unless there is a showing the public interest will be harmed.

The Plan allows Verizon to change prices for BLETs and OLETs in accordance with Sections F and G therein. We addressed Section G above. In Section F, the limits upon which Verizon may increase prices for BLETs and OLETs are established by Sections F.2, F.3, and F.4. In addition, Section F.1 permits price changes under 20 VAC 5-417-50 (E), "except the price ceiling shall be as set forth in Section F.2, F.3, and F.4 [of the Plan]." Thus, the Plan explicitly prevents Verizon from seeking changes, under 20 VAC 5-417-50 (E), to price

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<sup>37</sup> Contrary to the Staff's reiteration of arguments it made – and lost – during the Plan proceeding, 20 VAC 5-417-50 (D), (E), and (G) may be applied to Verizon subject to the limits imposed by the Plan. The Staff explains that 20 VAC 5-417-50 (D), (E), and (G), as originally promulgated, apply to CLECs. Thus, the Staff states that applying these rules to Verizon is "problematic" because Verizon is not a "new entrant" and "is not a carrier covered by ... 20 VAC 5-417-50 (E)." Staff's Reply at 8-9. The Staff further asserts that "Staff previously identified [its] concerns with allowing references to the CLEC Rules in Verizon's Plan," but the "Commission permitted the references to remain in the Plan as proposed by Verizon. ..." *Id.* at 8 (footnote omitted). The Plan Order, however, explains that "[v]arious parts of the Plan incorporate, by reference, rules promulgated by the Commission that apply to CLECs. We find that the substance of each of the referenced CLEC rules does not need to be repeated in the Plan to satisfy the public interest; incorporation by reference is sufficient." Plan Order at 22.

increases governed by Sections F.2, F.3, and F.4 of the Plan. Indeed, as noted by the Staff, Verizon expressly acknowledged the exception in Section F.1 during the hearing on the Plan.<sup>38</sup>

The Companies, however, ignore the existence of the exception in the instant proceeding. Verizon repeatedly asserts that the Commission may approve its Proposal under 20 VAC 5-417-50 (E), "*the existing price ceiling notwithstanding. . .*"<sup>39</sup> Verizon may wish to ignore the plain language of Section F.1 of its Plan, but we cannot.

Finally, we note that 20 VAC 5-417-50 (E) encompasses "pricing structures" in addition to "rates." Accordingly, if Verizon sought to modify a pricing structure while maintaining prices in accordance with Sections F.2, F.3, and F.4, the Plan provides that such request would be governed by 20 VAC 5-417-50 (E). The import of applying this rule is that Verizon's request would be evaluated under the same standard that the Commission would evaluate a similar pricing structure request from a CLEC. Specifically, as quoted above, the standard under 20 VAC 5-417-50 (E) states that "[t]he commission may permit such alternative pricing structures and rates *unless there is a showing the public interest will be harmed*" (emphasis added). Indeed, the Plan Order explains that, in accordance with § 56-235.5:1 of the Code of Virginia, "the Plan as approved herein takes steps, as appropriate, to treat all providers of local exchange telephone services in an equitable fashion and without undue discrimination and, to the greatest extent possible, to apply the same rules to all providers of local exchange telephone services."<sup>40</sup>

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<sup>38</sup> See Staff's Reply at 9 (quoting Woltz, Tr. 751 (Case No. PUC-2004-00092): "But Verizon's proposed plan would put it on the same terms and conditions that CLECs are on in that – not the same with respect to how the ceiling is set; that would be circular, as Ms. Cummings and the Staff pointed out, so there is a specific part of the plan that describes how that's done.")

<sup>39</sup> Amended Application at 5, and Verizon's Response at 8 (footnotes omitted) (emphasis added).

<sup>40</sup> Plan Order at 27-28.

For the reasons stated herein, we find that neither Section G nor Section F of the Plan supports Verizon's Proposal, and therefore we grant the Staff's Motion to Dismiss. This Order Dismissing Application is without prejudice to Verizon to file future applications in compliance with the terms of Sections G and F of the Plan.

Accordingly, IT IS HEREBY ORDERED THAT:

- (1) Verizon's Motion to Amend Application is granted.
- (2) The Staff's Motion to Dismiss is granted.
- (3) This matter is dismissed.

AN ATTESTED COPY hereof shall be sent by the Clerk of the Commission to:

Lydia R. Pulley, Vice President and General Counsel, Verizon Virginia Inc., 600 East Main Street, Suite 1100, Richmond, Virginia 23219-2441; Peter Q. Nyce, Jr., General Attorney, Regulatory Office, U.S. Army Litigation Center, 901 North Stuart Street, Suite 713, Arlington, Virginia 22203-1837; C. Meade Browder, Jr., Senior Assistant Attorney General, and Ashley C. Beuttel, Assistant Attorney General, Division of Consumer Counsel, Office of Attorney General, 900 East Main Street, 2nd Floor, Richmond, Virginia 23219; and to the Commission's Office of General Counsel and Division of Communications.

